

## Part B Consultation Questions – Volatility Control Mechanism

Please indicate your preference by checking the appropriate boxes and provide reasons to support your views. Where there is insufficient space, please attach additional pages as necessary.

1. Do you support the introduction of an instrument-level VCM based on a dynamic price limit model in Hong Kong?

Yes

No

Please give reasons for your view.

2. Do you agree that the proposed VCM model should only be applied to the HSI and HSCEI constituent stocks in the securities market?

Yes

No

Please give reasons for your view.

Our preference would be that VCM should be universally applied to all stocks eventually, to ensure uniformity.

3. Do you agree that the proposed VCM model should only be applied to the HSI, HHI, MHI & MCH (spot month and the next calendar month) index futures in the derivatives market?

Yes

No

Please give reasons for your view.

As above we feel that the VCM should be universally applicable.

4. Do you agree that the market should have a 15-minute uninterrupted trading period before the end of the last continuous trading?

Yes

No

Please give reasons for your view.

The time leading into the close is a crucial period to allow investors time to complete orders should liquidity permit, so in principal we agree that an uninterrupted trading period is a definitive requirement. Our suggestion would be to allow the VCM to interrupt on an indefinite number of occasions prior to this, and not restrict this to two times. As you noted, the aim of the VCM is to prevent erroneous trading by controlling the range of execution prices, so should be in effect for the duration irrespective of how many times it is triggered.

5. Do you agree with the proposed reference price for the securities market, namely the price of last trade 5 minutes ago? If not, what would you prefer?

Yes

No, I would prefer: \_\_\_\_\_

Please give reasons for your view.

Other markets have implemented a 5 minute window so it is well understood.

6. Do you agree with our proposed reference price for the derivatives market, namely the price of last trade 5 minutes ago? If not, what would you prefer?

Yes

No, I would prefer: \_\_\_\_\_

Please give reasons for your view.

Our recommendation would be that the VCM be expanded in the future, to use a price limit with reference to the previous day's settlement price, which is fairly common amongst institutions

7. Do you agree with the proposed triggering level for the securities market, namely 10% from the reference price across the proposed instruments covered by the VCM? If not,

what level would you prefer?

Yes

No, level that I would prefer: \_\_\_\_\_

Please give reasons for your view.

10% supports the need to balance the price discovery process against the interruption caused by an erroneous event, given that at 10% this would yield few exceptions. We would like to see a future review to determine whether 10% is the most appropriate, especially against a wider range of stocks.

8. Do you agree with the proposed triggering level for the derivatives market, namely 5% from the reference price across the proposed instruments covered by the VCM? If not, what level would you prefer?

Yes

No, level that I would prefer: 10%

Please give reasons for your view.

A 10% trigger for all instruments would be beneficial for uniformity to the cash market. However, different triggering levels may be called for based on liquidity, when the decision is made to expand the VCM to stocks outside the HSI and HSCEI.

9. Do you agree that a maximum of two VCM triggers per trading session per instrument should be imposed to minimise market interruption?

Yes

No, I would prefer: Unlimited

Please give reasons for your view.

As stated in response to # 4, our view would be to continually evaluate market prices on the VCM leading up to the final 15 minutes, irrespective of how many times it is triggered. This would fully enforce the spirit of what the VCM aims to achieve.

10. Do you support trading within a price limit during the cooling-off period? If not, do you prefer another approach?

Yes

No, another approach that I prefer: \_\_\_\_\_

Please give reasons for your view.

An alternative is to look at the potential of an auction process as part of the trading halt to enable participants to reset the market level.

11. After the cooling-off period, do you support resuming the same dynamic price limit monitoring mechanism (i.e.  $\pm 10\%$  ( $\pm 5\%$ ) from the last trade 5 minutes ago in the securities (derivatives) market)? If not, do you prefer another approach?

Yes

No, I would prefer: \_\_\_\_\_

Please give reasons for your view.

Yes, for reasons given above.

12. Do you have any other suggestions on enhancing the resumption procedures?

As #10, an alternative is to look at the potential of an auction process as part of the trading halt to enable participants to re-establish the market level

13. Do you agree that the duration of the cooling-off period should be 5 minutes for both the securities and derivatives markets? If not, what would you prefer and why?

Yes

No, I would prefer: \_\_\_\_\_

Please give reasons for your view.

5 minutes is inline with VCM solutions in other markets

14. Do you agree with the additional market data dissemination for the proposed VCM model? If not, what would you propose and why?

Yes

No, I would propose: \_\_\_\_\_

Please give reasons for your view.

This is critical for market participants to get the relevant market data related to the VCM, for transparency and to trigger action.

15. If a VCM is triggered for a given instrument, should trading of related instruments (e.g. futures contract of different contract months) on the same underlying continue as normal?

Yes

No

Please give reasons for your view.

16. If a VCM is triggered for a given instrument, should trading of derivatives (e.g. single stock options or warrants) of that instrument continue as normal?

Yes

No

Please give reasons for your view.

17. Do you have any other comments on the VCM proposal?

strongly supports the HKEx's decision to implement a VCM. We recognise the need to balance price protection against price discovery, and recognise the effort required in drawing the boundaries for a dynamic market like Hong Kong. We would suggest that the VCM model should be reviewed periodically to ensure that it reflects the current state of the market.

## Part C Consultation Questions – Closing Auction Session

18. Do you support the introduction of the new CAS model in the Hong Kong securities market?

Yes

No

Please give reasons for your view.

Research indicates that a closing auction can reduce volatility, and as such is commonly used in other markets. Add to that the fact that there is a large amount of institutional money benchmarked to the close, the auction would provide a more efficient way for the market to determine the closing price, and reducing the volatility and resulting slippage that comes with trying to achieve the closing price using the existing methodology.

19. Do you agree that the new CAS model should only be applied to the major index constituent stocks (i.e. Hang Seng Composite LargeCap Index and Hang Seng Composite MidCap Index constituents as well as other Stock Connect Securities for Southbound trading)?

Yes

No

Please give reasons for your view.

For consistency the CAS should be applicable to all constituents. The lack of uniformity in market rules will make the HK market harder to navigate for anyone holding a broad set of stocks.

20. Do you agree that the new CAS model should be applied to ETF? If yes, which type of ETF should be applied?

Yes

(i) Apply to all ETFs

(ii) Only apply to ETFs with Hong Kong stocks as underlying

No

Please give reasons for your view.

As in #19 we feel strongly that consistency is key.

21. Do you agree that at a later stage, the new CAS model should be expanded to other equity securities and funds as proposed? If so, when should the CAS be rolled out to these securities and funds?

Yes, roll out time should be: As soon as practicable

No

Please give reasons for your view.

22. Do you agree that that the new CAS model should exclude structured products, equity warrants and debt securities?

Yes

No

Please give reasons for your view.

Structured products, warrants, and debt securities have very different characteristics from equities; in particular, they generally do not have MOC execution needs, as noted in the text. Hence there's less market demand for a CAS for these instruments and the CAS being considered in this consultation is likely less suitable for them. This is confirmed by market practices elsewhere.

23. Do you support introducing a price limit during the CAS?

Yes

No

Please give reasons for your view.

A price limit can be justified to contain extreme volatility, but this may shift volatility into the pre-closing period. To get the right balance, and price limit during the CAS should not be too restrictive.

24. Do you support a price limit of 5% during the Order Input Period for all CAS Securities?

Yes

No

Please give reasons for your view.

We believe the price band should be wider, at least 7.5%, which would encompass approximately four standard deviations of price movements on major rebalancing days. The price band should be wide enough to be relatively un-restrictive while fulfilling the purpose of providing a constraint on extreme volatility. A tight price band discourages trading in an auction as it increases order incompleteness risk and introduces more volatility around the limit of the band. In fact, as has been observed in Korea, a wider price band is associated with lower volatility. The reason is that a too-narrow band for the closing auction drives more volume into the pre-auction period, increasing volatility prior to the auction and reducing the utility of the auction itself. A narrower limit than 7.5% would unnecessarily hamper the price discovery process.

25. Do you agree that a further price limit within the best bid and best ask should be applied during the No-Cancellation Period and Random Closing Period?

Yes

No

Please give reasons for your view.

No, we think this is an unnecessary constraint on the price discovery process.

26. Do you agree that at-auction limit orders should be allowed throughout the CAS?

Yes

No

Please give reasons for your view.

Limit orders facilitate price discovery and would provide more liquidity for the auction.

27. Do you think short selling orders with a tick rule should be allowed during the CAS?



Yes

No

Please give reasons for your view.

Short selling is a commonly used mechanism for hedging and risk management. Short selling during the CAS will help to make the CAS more liquid and also reduce any volatility incurred prior to the CAS

28. If short selling order is to be allowed, should it be at or higher than the reference price?

Yes

No

Please give reasons for your view.

The uptick rule is sufficient, since it is uniform to current convention in the Hong Kong market.

29. Do you agree that order amendment and cancellation should be disallowed during the No-Cancellation Period and Random Closing Period?

Yes

No

Please give reasons for your view.

30. Do you agree that random closing be adopted in the CAS to prevent gaming?

Yes

No

Please give reasons for your view.

31. If random closing is to be adopted, should it be over a period of up to 2 minutes or would you prefer a different duration?

Up to 2 minutes

A different duration: 1 minute

Please give reasons for your view.

We believe a two-minute window for the random close is longer than necessary. We believe that a one-minute window, would be sufficient.

32. In the absence of a final IEP, do you agree that the reference price should be used as the closing price and for trade matching?

Yes

No

Please give reasons for your view.

The existing closing price, which is determined by taking the median of 5 nominal prices in the last minute, is familiar to the Hong Kong market and would minimize development and education efforts. A VWAP reference price would be better on theoretical ground and hardest to game, but at the cost of added complexity. This could be a possibility to re-consider at a later stage.

33. What would be the preferred duration of the CAS?

(i) Same as the proposed model, i.e. 7-minute Order Input Period to end the CAS at 16:12

(ii) 5-minute Order Input Period to end the CAS at 16:10

(iii) Others, please specify:

Approach (i)

Approach (ii)

Approach (iii), please specify: \_\_\_\_\_

Please give reasons for your view.

The seven-minute period provides enough time in which orders can be entered, amended, and cancelled.

34. Do you agree that some features of the new CAS model may also be beneficial for the POS and/or the Trading Halts? If so, which feature(s)?

Yes, the feature(s): The auction component of CAS

No

Please give reasons for your view.

We believe the CAS mechanism, for all the reasons discussed in the HKEx consultation, the experience of other markets, and academic literature, would be optimal for the opening as well as the close.

35. Do you agree that any enhancements for POS and/or the Trading Halts should be implemented later rather than during the introduction of the new CAS?

Yes

No

Please give reasons for your view.

We think it is critical for the HKEx to adopt a Closing Auction Session. An enhanced POS and trading halts can come at a later stage in order to increase market acceptance of the principle of the CAS. Similarly, if based on market feedback HKEx should decide that the VCM model requires further development from what has been proposed in this consultation, we would recommend launching the CAS rather than waiting in order to launch the CAS and VCM simultaneously.

36. Do you foresee any issues with your day end processing such as margin calls in the cash market due to the extended trading time for 12 minutes? If yes, how may the issue be resolved?

Yes, suggested solution: \_\_\_\_\_

No

Please give reasons for your view.

37. To maintain the 45 minutes break before the start of AHFT, do you agree that the start time of AHFT to be changed from 17:00 to 17:15? If not, what time do you prefer?

Yes

No, time that you prefer: \_\_\_\_\_

Please give reasons for your view.

## Part D Consultation Questions – Implementation Approach and Timeline

38. Which implementation approach for the securities market would you prefer:
- (i) the development and testing of the VCM, CAS and Trading Halts functionalities are to be implemented together on the AMS/3.8 platform and be rolled out one by one; or
  - (ii) (1) the development, testing and rollout of VCM and CAS are to be implemented together on the AMS/3.8 platform, and (2) Trading Halts proposal is to be introduced as part of the Exchange's next-generation trading system, the Orion Trading Platform-Cash; or
  - (iii) Others, please specify.
- Approach (i)
- Approach (ii)
- Approach (iii), please specify: \_\_\_\_\_

Please give reasons for your view.

Both the CAS and VCM are high priority items that will require effort both from an order management perspective as well as dissemination of the new rules.

39. What should be the implementation priority among the three initiatives (i.e. VCM, CAS and Trading Halts) in the securities market?

Please give reasons for your view.

The CAS should be the first priority. As referenced in our answers above it would have the most positive impact to the market. VCM and Trading Halts are important but can be added at a later stage if the HKEx chooses to do it in the proposed manner.

40. How long do you need to prepare for the rollout starting from the issuance of the specification for each initiatives:

- (i) VCM:
  - a). under 3 months;

- b). 4-6 months;
- c). 7-12 months
- d). >12 months

Please give reasons for your view.

There will be changes required in our OMS to support the VCM. Adequate time is required to effect and rigorously test these changes.

(ii) CAS:

- a). under 3 months;
- b). 4-6 months;
- c). 7-12 months
- d). >12 months

Please give reasons for your view.

There will be changes required in our OMS to support the CAS. Adequate time is required to effect and rigorously test these changes

- End -